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TAGS: ECON EFIN ELAB PGOV IT EUN
SUBJECT: GOI PASSED PASSES A DEFICIT REDUCTION PACKAGE

REF: A) ROME 2653

B) ROME Economic scorecard2630

Summary

¶1. As previously announced by PM Berlusconi, the Italian Cabinet passed on July 9 by decree law a euro 7.5 billion, or 0.6 percent of GDP deficit reduction package, as under pressure from the EU European Commission had requested. The package includes euro 4.2 billion in structural spending cuts, euro 1.3 billion in tax reductionsincreases, and euro two billion in one-off measures (state-owned property sales and delay of expenses). GOI also extended to December the deadline for the amnesty for illegal builders. While such additional budget measures are reportedly viewed positively at the EU level, domestically both unions and industry representatives foresee a negative impact on economic growth. End- summary.

The Additional 2004 Budget Package

¶2. Following through on PM Berlusconi's promise to at the July 5 ECOFIN meeting, the GOI on June 9 has approved a deficit reduction package to for the 2004 budget that should reduce the deficit by euro 7.5 billion euros, or 0.6 percent of GDP. This additional budget measure was approved by means of a decree-law (thatwhich goes immediately into force immediately, though Parliament must approve the decree-law after the release in the Official gazette nad have to be within sixty days) . (Note: if it is not, it is common practice to re-issue another decree law in slightly changed format until the Parliament can take action. End note.) and will reportedly allow Italy to remainThe measure is intended to keep Italy within the three percent EU-mandated deficit ceiling in 2004. The package includes euro 4.2 billion in structural spending cuts, euro 1.3 billion in tax reductionsincreases, and euro 2 billion in one-off measures (state-owned property sales and delay of expenses). The GOI also extended to December the deadline for the amnesty for illegal builders, hoping to attract additional revenue from fees paid by those seeking to legalize previously-unapproved construction projects.. The measure also cuts special funds to institutions, including the Italian postal service and the Italian state railways, with estimated savings of euro 350 million. The package also includes cuts to the MFA's development cooperation fund.

¶3. The largest part of the euro 4.2 billion euro spending cut is a euro 2.6 billion cut in euro of the administrative spending, implemented through a fifteen percent cut of in ministries' spending and a ten percent cut in transfers to spending of local governments. The Ministry of Defense (MOD) is the ministry most affected by the cuts, though the approximately euro one billion in MOD cuts was reduced from euro 1.8 billion after much criticism that the original cuts would have "paralyzed" the armed services. GOI The plan also cut reduces transfers to the Mezzogiorno (the underdeveloped southern third of the countryItaly) by euro 1.25 billion euro. This amount includes a decrease in cut to funds for aimed to employment support employment to companies operating in the south.

¶4. On the revenue side, the GOI plans to raise euro 1.3 billion euro from banks, insurance companies, and on trade institutions. For insurance companiesT the decree increases the annual tax on the insurance reserves of insurances and pension funds from 0.20 to 0.30 percent, which should. This measure is aimed to increase revenues by euro 700 million euro. GOI The plan also increased increases the tax base for IRAP, (the regional tax on productive activities, to banks, and bBrokerage firms) that is expected to produce euro 370 million in additional revenue euro. For other institutions, first ofprimarily all banking foundations, the GOIGOI plan eliminates some certain tax benefits producing anthat should increase of tax pressure and revenues by euro

230 million euro.
There is also a cut of special funds to some institutions such as Poste Italiane, National Mail Service, and State Railways and for special advisory services estimated at 350 billion euro. The package also includes cuts to MFA fund for cooperation to development.

¶5. GOI also extended the deadline for the amnesty for illegal builders form July 31 to December 10. This measure is aimed to have a positive impact on revenues and offset further possible shortfall.

What next?Next Steps

¶65. The GOI must now would approvebe the preparation and the approval of the 2005-2008 DPEF (Documento di Programmazione Economica e Finanziaria (Economic and Financial Planning Document) or DPEF, a four-year economic plan that sets fourth economic/budgetary goals for each year through 2008. Approval of the plan is overdue, and the GOI is attempting to finalize it before the August vacation period. On July 8, in his role as talking as acting Finance Minister, PM of Economy atBerlusconi also told the annual meeting of the Italian banking association that he still plans to seek Parliamentary approval of pension reform legislation with a mentioned the GOI target to approve in Parliament the pension reform wit ha confidence vote before the summer recess.

The EU "Early Warning"

¶76. The GOI's approved the deficit reduction package , which goesenters immediately into force, to thus helping Italy avoid an early warning from the European Union over theItaly's rising budget deficit from the European Union. At the end of In late April, the EU European Commission had warned Italy that its deficit risked hitting 3.2 percent of GDP this year (3.5 percent, according to more recent estimates) and four percent in 2005, unless corrective measures were quickly taken. On July 8, Berlusconi assured stated that "Italy intends to take all necessary steps to keep the deficit-to-GDP ratio under three percent," adding that, "Several several important European countries have exceeded this limit and intend to do so again."

¶8. Italy's debt, equal to 106.2 percent of GDP in 2003, is the largest in the EU and the third largest in the World. The EU ministers also urged Italy to speed up the debt reduction process, saying they would continue to monitor progress in this area in 2004 and 2005.

¶97. The EU reacted positively to the GOI decision deficit reduction package, withand the Commissioner for Monetary Affairs Joaquin Almunia said saying the measures "correspond more or less to what we were asking for. Now we have to see what happens next year, particularly regarding Italy's public debt." (Note: Italy's public debt equaled 106.2 percent of GDP in 2003, the largest in the EU and the third largest in the world.)

Comment

¶108. After three years of one-time measures and on-going debate with little result, the Berlusconi government, under the threat of the EU "early warning" and the downgrading of Italy's huge public debt, is passed a small, but still unpopular, deficit reduction package. The tax increase and abolition of some incentives and transfers are expected to have a negative impact of on companies, investment and GDP growth, especially in the Southsouthern Italy. Predictably, union, industry, and local government comments onDomestically the comments the deficit reduction package were generally negative, mostly were generally negative.

¶119. Even in this critical situation, however, the GOI cannot avoidcontinues to use some of the creative financing techniques of former Finance Minister Tremontie". The GOI expects to save euro two billion euro from postponement of the some expenses, seal sale of some state properties, and extend extending the amnesty deadline for of the amnesty forillegal builders to December.

¶1110. Unfortunately, this is only the first step of the post-Tremonti era. The achievement ofKeeping within the EU three percent target limit in 2005, but also implementing Berlusconi's of thepromised tax cuts, would require very likely request aneven tougher budget cuts for FY 2005,

estimated estimated atto be some euro 30 billion. End Comment.

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